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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

AMERICAN CHICLE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General on behalf of David Burnet, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above cause on May 15, 1933, affirming the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 19–29) is reported in 23 B.T.A. 221. A memorandum opinion (R. 42–44) accompanying an order of the Board denying the petitioner's motion for reconsideration and modification of the decision is

not reported. The opinion of the Circuit Court of Appeals (R. 57–58) is reported in 65 F. (2d) 454.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 15, 1933. (R. 58.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondent acquired all the assets of another corporation and assumed its liabilities, including its outstanding bonds. Did the respondent realize taxable income by the purchase from the public in subsequent years of a number of the bonds at prices less than their par or face value?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra,* pp. 10–11.

STATEMENT

The facts as stipulated and found by the Board of Tax Appeals (R. 21–25) may be summarized as follows:

In August 1914, the respondent acquired all of the assets of the Sen Sen Chiclet Company, a Maine corporation, and assumed the payment of its liabilities, among which were $2,425,000 par value of

bonds then outstanding and unredeemed. The bonds had been issued by the Sen Sen Chiclet Company in 1909 of a total face value of $2,700,000, maturing May 14, 1929, with a sinking-fund clause providing that a deposit be made with the trustee of at least $50,000 per year to provide for the purchase of bonds submitted to the trustee in open bid by bondholders under the terms of the indenture. (R. 21.)

During the year 1922, the respondent purchased from the public $82,000 par value of Sen Sen Chiclet Company bonds for which it paid a total of $55,650.94, making a difference of $26,349.06 between the par value and the redemption price.[1] (R. 21.) During the year 1924, the respondent and the trustee of the sinking fund purchased from the public $59,000 par value of these bonds, paying therefor $47,602.10, the difference between the par value of the bonds and the redemption price being $11,397.90. (R. 22–23.) During the year 1925, the respondent and the trustee of the sinking fund purchased a total of $201,500 par value of the bonds and paid therefor $186,146.31, or $15,353.69 less than the par value of the bonds. (R. 24.)

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[1] The deficiencies in issue are for the taxable years 1924 and 1925. The amount of income for 1922 is involved in the computation of the amount of a statutory net loss for that year to be carried forward to the year 1924.

The Commissioner included the difference between the par value and the redemption price in income for each of these years. (R. 21–24.) The Board of Tax Appeals held that these amounts did not constitute taxable income. (R. 25–26.) On a rehearing, the Board reversed and modified its opinion upon another issue not now involved, but refused to alter its determination with respect to the present question. (R. 34–36.) Subsequently a motion for reconsideration and modification of the decision, filed by the Commissioner, was denied. (R. 40–44.) The Circuit Court of Appeals affirmed the decision of the Board. (R. 57–58).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the respondent realized no taxable gain or income by the purchase and retirement of the bonds at amounts less than their par value.

2. In affirming the order of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. We submit that the decision of the Circuit Court of Appeals is erroneous and in conflict with the principles underlying the decision of this Court in *United States* v. *Kirby Lumber Co.*, 284 U.S. 1. The Circuit Court of Appeals held here that where the taxpayer receives money for a bond obligation

and subsequently retires the bonds at less than par, taxable income is realized; but that where the obligation is incurred in the acquisition of property which it still holds, the obligor has not realized taxable gain by the purchase and retirement of the obligation. We believe that the decision in the *Kirby Lumber* case applies to both situations since it is based, not on the nature of the property acquired when the bonds are issued, but on the effect which their retirement has upon the financial situation of the obligor.

This Court held in the *Kirby Lumber* case that the taxpayer had realized an accession to income since "as a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct." The same situation exists here. Presumably the value of the assets acquired by the respondent equaled the amount of the liabilities assumed; at least the respondent has not shown that the property was worth less. Therefore, at the time of this transaction, the assets were offset by equivalent obligations. By the use of its capital in its subsequent dealings the respondent has made available a portion of its assets free from the obligation of the bonds. In holding that this extinguishment of the obligation did not constitute taxable income the decision of the court below is also apparently in conflict with the basis of the decisions in *Chicago, R. I. & P. Ry. Co.* v. *Commis-*

sioner, 47 F. (2d) 990 (C.C.A. 7th), certiorari denied, 284 U.S. 618, and *Charleston & W. C. Ry. Co.* v. *Burnet,* 50 F. (2d) 342 (App.D.C.), which hold that unpaid wages, carried in a suspense account awaiting demands of employees, are to be treated as income in the year in which they are charged to profit and loss on the assumption that they will never be claimed.

The error of the court below lies, we believe, in its disregard of the fact that the situation here involves two independent transactions. In the first, property was acquired and its cost fixed by the amount of the obligations assumed in consideration therefor. The cost of the property was then determined as definitely as if the payment had been made in cash. Since the respondent's books were kept on the accrual basis (R. 25), there is no significant distinction between a payment made by decreasing assets on the one hand or by increasing liabilities, as in this case. So far as the purchase of the property was concerned it was a completed transaction when the respondent assumed the liability represented by the bonds. The bonds were thereafter retired in a separate series of transactions occurring in subsequent years between the respondent and persons other than the corporation from which the property was acquired. Whether gain or loss arises on the subsequent payment of

the obligation is a matter to be considered by itself, with its own tax results. There seems to be no basis for the holding that the cost of the property acquired by the assumption of the obligation of bonds remains uncertain, perhaps over a period of many years, until it appears whether the bonds will be paid in full or bought at a reduced figure. If the property was sold before the bonds were retired, no one would contend, we submit, that the cost of the property was incapable of determination because the outstanding bonds might thereafter be retired at less than their face value.

The Government should not be required to await the sale or disposition of the assets before taxing the gain realized by the favorable retirement of the bonds. The income-tax statutes are based upon a system which taxes gains annually rather than one which must await the final outcome of a given transaction. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359.

2. The decision below is in direct conflict with that of the Circuit Court of Appeals for the First Circuit in *Commissioner* v. *Coastwise Transp. Corp.*, 62 F. (2d) 332. There the taxpayer issued serial notes in part payment of the purchase price of a fleet of ships. It subsequently retired the notes at less than face value by purchases for cash and by the substitution of bonds. The Circuit Court of Appeals, relying on the *Kirby Lumber* case, re-

versed the Board and held that on the facts taxable income resulted.[2] We submit there can be no distinction between a case in which a corporation issues its own bonds in the purchase of property and a case in which the corporation acquiring the property assumes the obligation of the bonds. The court below in the instant case made no such distinction but rested its decision upon the difference between obligations whose consideration is money and those issued or assumed for property which the obligor still holds.

3. The question presented is involved under all of the Revenue Acts and is of importance from an administrative standpoint. The Bureau of Internal Revenue advises that there are pending at

[2] Since the decision in the *Coastwise Transportation* case was handed down, the Board has taken additional evidence under the mandate of the Circuit Court of Appeals and has reached the conclusion that the decision in the *Kirby Lumber* case does not apply, since the additional evidence indicated that by reason of operating losses and depreciation the taxpayer's balance sheets showed deficits at the beginning of each of the taxable years. See *Coastwise Transportation Corp.* v. *Commissioner*, decided by the Board of Tax Appeals July 21, 1933, and not yet reported. An extract from the opinion may be found in Vol. I, Prentice-Hall, 1933, p. 2234. An appeal has been authorized from the new decision of the Board, which is considered erroneous because of the failure to treat the retirement of the notes as separate transactions in the years in which they occurred. The new decision of the Board, we believe, shows the need for a further consideration by this Court in order to determine the extent of the application of the decision in the *Kirby Lumber* case.

present ten cases involving more than $650,000 in taxes in which the specific question is presented whether a successor corporation acquiring property from its predecessor by the assumption of the predecessor's obligations derives income upon a subsequent retirement of such obligations at less than their par value. Moreover, as we have indicated above, the decision below is equally applicable to a situation where the taxpayer has itself issued the obligation in the acquisition of property. It may be noted also that the regulation provides that where bonds are retired at a price in excess of the issuing price or face value the difference is a deductible expense for the taxable year. Cf. Article 545 (1) of Regulations 62, 65, and 69 (*infra*, p. 11). The proper treatment of all such situations is left in confusion because of the conflict between the decision in the instant case and that in the case of *Commissioner* v. *Coastwise Transp. Corp., supra.*

Wherefore it is respectfully submitted that this petition should be granted.

J. CRAWFORD BIGGS,
Solicitor General.

AUGUST 1933.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1921, c. 136, 42 Stat. 227, 237, 254:

> SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.
>
> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

The provisions of Sections 233 (a) and 213 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253 (U.S.C., Title 26, Sections 985 and 954) and the Revenue Act of 1926, c. 27, 44 Stat. 9 (U.S.C.App., Title 26, Sections 985 and 954) are the same as the

above-quoted provisions of the Revenue Act of 1921.

Regulations 62, promulgated under the Revenue Act of 1921:

> ART. 545. *Sale and retirement of corporate bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. See section 234 of the statute and article 563. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

The provisions of Article 545 (1) of Regulations 65 and 69 promulgated under the Revenue Acts of 1924 and 1926 are the same as the above-quoted provisions of Article 545 (1) of Regulations 62.

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